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In The
Supreme Court Of The United States
October Term, 1993

FRANCIS R. SABLONE, JR.,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY

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QUESTIONS PRESENTED FOR REVIEW

1. Does SEC Rule 10b-5 impose criminal sanctions for the "misappropriation" of information contained in a weekly periodical, when the only victim of the alleged fraud is the publisher of the periodical?

2. Can information contained in a weekly periodical be considered "non-public" and "confidential" for purposes of Rule 10b-5 when the information is voluntarily disseminated by the publisher prior to the "official" release time of the magazine and where the market already reflects trading on the information?

3. Does Rule 10b-5 prohibit trading on information until such time as the information has been "impounded" into the market price of the security involved?

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PETITIONER'S REPLY

ARGUMENT

A. RULE 10b-5 SHOULD NOT BE EXTENDED TO IMPOSE CRIMINAL SANCTIONS FOR FRAUD ON NON-MARKET PARTICIPANTS.

In his brief in opposition to the petitioner's writ, the Solicitor General fails to acknowledge that this case differs from almost all other actions involving the "misappropriation" theory of securities fraud first enunciated by the Second Circuit Court of Appeals in *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983). With the exception of *Carpenter v. United States*, 484 U.S. 19 (1987), in those actions in which the defendant was charged with misappropriating material, non-public and confidential information and using that information to trade in securities, the owner of the information had an undeniable interest in the actual purchase or sale of the traded security. *See, e.g., SEC v. Cherif*, 933 F.2d 403 (7th Cir. 1991), *cert. denied*, 112 S. Ct. 966 (1992); *SEC v. Clark*, 915 F.2d

439 (9th Cir. 1990); *SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985); *Newman*, 664 F.2d 12.[1]

Here, as in *Carpenter*, however, the owner of the allegedly misappropriated information had no intention of utilizing that information to maximize profit or limit loss by using the information in a securities transaction; rather, the value of the information lay solely in its possession and in the privilege of deciding when to release it. There is no claim that the Wall Street Journal in *Carpenter* or McGraw-Hill in this action suffered any loss by virtue of the actual trading which occurred after the misappropriation. To the contrary, any harm

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[1] The Solicitor General chides the petitioner for failing to challenge the creation of the misappropriation doctrine, the validity of which has never been approved by this Court. Brief in Opposition (hereinafter "Opp.") at 7. The petitioner responds that it is unnecessary for this Court to perform that global evaluation where the application of that doctrine in this case is so clearly misguided. Of course, it remains within this Court's power to perform that review, despite the absence of urging by the petitioner.

suffered by these entities came about from the loss of control over the information: whatever use was made of the information after that loss was irrelevant to their interests.[2] This is in sharp distinction to those who are victimized by virtue of their participation in the stock market, injuries which inarguably fall within the scope of federal securities laws.

It is this crucial and obvious difference between victims which distinguishes this matter from the cases relied on by the Solicitor General (Opp. at 6) and which compels review of the petitioner's conviction by this Court. The Solicitor General's reluctance to address the significance of whether the owner of the misappropriated information is a non-market participant can be fairly

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[2] In addition, because that loss has been interpreted to be nothing more than a loss of reputation, which is actionable at common law, there would be no purpose in providing relief under federal securities laws to these "victims" of misappropriation. *See Carpenter v. United States*, 791 F.2d 1024, 1037 (2d Cir. 1986)(Miner, J., dissenting).

interpreted as an inability on his part to justify such an unreasonable expansion of section 10(b) and Rule 10b-5.[3] This Court should accept review of this matter in order to properly restrict the application of Rule 10b-5 to schemes to defraud market participants, leaving any other causes of action to the control of the common law.

B. UPON RELEASE TO THE MEDIA, THE CONTENTS OF *BUSINESSWEEK* WERE NO LONGER "NON-PUBLIC" NOR "CONFIDENTIAL" WITHIN THE MEANING OF RULE 10b-5.

Contrary to the Solicitor General's report (Opp. at 13), the petitioner does claim that dissemination of *BusinessWeek* to members of the media constitutes a

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[3] In arguing that the type of victim is irrelevant, the Solicitor General reports that Congress has never drawn a distinction between fraud perpetrated on market participants versus non-market participants. (Opp. at 10). The Solicitor General's own citation to authority for that proposition reveals the inaccuracy of his claim: Although Congress has authorized a private cause of action for those who trade "contemporaneously" with a defrauder; 15 U.S.C. § 78t-1; no such private cause of action has been expressly created for those who suffered a loss which is unrelated to trading.

release of the contents to the public. As set forth in the petition (Pet. at 18-21), McGraw-Hill's decision to distribute hundreds of copies of the magazine prior to its own 5:00 p.m. embargo deprives it of the right to later claim that any information contained therein remained both "confidential" and "non-public" until that arbitrary deadline. The Solicitor General's contention that the confidentiality of the information was preserved by the rules of professional courtesy[4] cannot alter the fact that McGraw-Hill knowingly and voluntarily furnished copies of the periodical to members of the media, whose very purpose in life is to disseminate information and who had absolutely no duty, legally or ethically, to refrain from doing so. *See, e.g., United States v.*

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[4] Even if professional courtesy was sufficient to guarantee that the information would be kept "under wraps," (Opp. at 13), the only information restricted by McGraw-Hill in its distribution was that contained in the press release, which did not concern the contents of the "Inside Wall Street" column. At no time was the media instructed to resist reading the magazine itself or, obviously, to refrain from trading on any information contained therein.

Chestman, 947 F.2d 551, 567 (2d Cir. 1991)(en banc), *cert. denied*, 112 S. Ct. 1759 (1992)("[A] fiduciary duty cannot be imposed unilaterally by entrusting a person with confidential information.").

To accept the Solicitor General's view of the harmlessness of this mass distribution, this Court would have to first retreat from its statement in *Dirks* that for information to be confidential, there must be an expectation of privacy. *Dirks v. SEC*, 463 U.S. 646, 655 n.14 (1983). Second, this Court would also have to adopt differing levels of publication; i.e., that widespread distribution of information to one segment of the populace (here, the media) does not constitute publication for purposes of the securities laws. Such a distinction would be illogical and ill-advised.

C. WHETHER INFORMATION HAS BEEN "IMPOUNDED" INTO THE PRICE OF A SECURITY IS IRRELEVANT TO THE APPLICATION OF RULE 10b-5.

Both the Solicitor General and the petitioner agree that the Court of Appeals erred by introducing an

"impoundment" factor into the calculus used to determine whether information is public for purposes of Rule 10b-5.[5] (Opp. at 15 n.7). While the Solicitor General counsels that consideration of this departure from established law can "await" review in some future case, however, the petitioner contends that such a delay would not serve the interests of justice.

First, the Solicitor General is incorrect in implying that consideration of this new element does not affect the outcome of this particular matter. As can be seen from the Court of Appeals's decision, that tribunal duly noted that information may be considered public "even though there has been no public announcement

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[5] It is worth noting that the court below cited no authority in support of this new impoundment factor nor does the Solicitor General in urging this court to let the doctrine await review in the future. Clearly, the petitioner could not have anticipated this new rule of law in his own defense nor did the trial court address it in its charge to the jury. To allow this acknowledged error to remain a rule of law until an undetermined date defies logic and all principles of jurisprudence.

and only a small number of people know it." (Pet. App. at 20a). This concession was followed by the announcement that the determining factor is not how many people may possess the information, "but whether their trading has caused the information to be fully impounded into the price of the particular stock." (*Id.*). Thus, it is evident that the Court of Appeals did not base its affirmance of the petitioner's conviction on a conclusion that the information was not widely-known, but rather on its analysis of whether the market had fully absorbed the effect of the release of the information. Absent the latter determination, the Court of Appeals would have been forced to acknowledge that the fact of wide-spread trading on the information led ineluctably to the conclusion that the information was no longer confidential by the time it reached the petitioner.[6]

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[6] It should also be kept in mind that the petitioner's conviction has had and will continue to have significant effects on his life. Although he has served the sentence imposed on him as a result of this criminal conviction, the petitioner has had judgment enter against him in a parallel

A second, equally-compelling reason to review the Court of Appeals's decision at this time is to prevent the confusion among the lower courts and circuits which this new "impoundment" element is bound to engender. The likelihood of such confusion is made evident by the fact that the petitioner and the Solicitor General cannot agree as to the effect of impoundment in this particular case. The Solicitor General interprets the Court of Appeals's decision to create an alternative means by which information can be proven to be public: either by public announcement or by price absorption. (Opp. at 14). As outlined *supra*, however, the petitioner believes that the Court of Appeals applied the

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civil action brought against him by the Securities and Exchange Commission.

In addition, the petitioner, an attorney, also faces grievance proceedings in both the state and federal tribunals where he faces possible disbarment. If the Court should agree with the petitioner and the Solicitor General that the Court of Appeals's "impoundment" theory should be reviewed, it would be manifestly unjust to delay that review and allow the petitioner's conviction to stand.

impoundment factor as an additional requirement: not only must the information be public (however publication is accomplished), but the price of the stock must also have absorbed the public's reaction to the release of the information before trading can be legitimized.

That such contrary interpretations can be drawn from the announcement of this new element does not bode well for future application of the Court of Appeals's latest pronouncement in this area of the law. Absent review of this new requirement, other panels of the Second Circuit as well as all of the District Courts within this circuit, will be bound to adhere to this new definition of securities fraud. *See, e.g., Kremer v. Chemical Constr. Corp.*, 623 F.2d 786, 788 (2d Cir. 1980), *aff'd*, 456 U.S. 461, *reh'g denied*, 458 U.S. 1133 (1982). In order to deflect unwarranted application of this erroneous interpretation of section 10 and Rule 10b-5, this Court should grant the relief sought by the petitioner.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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